

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

In Re)	
)	
RAVENSWOOD APARTMENTS, LTD.)	Case No. 04-15832
)	
)	Chapter 11
Debtor)	
)	Judge Burton Perlman
-----)	
-)	
)	
James F. O'Brien, Trustee)	
)	
Claimant)	
)	
vs.)	
)	
Ravenswood Apartments, LTD.)	
)	
Objector)	

DECISION ON DAMAGES

This Chapter 11 case has to do with certain real property

consisting of several residential apartment buildings bearing the name Ravenswood Apartments (hereafter "the property"). James F. O'Brien, trustee, sold the property to debtor in a Land Installment Contract ("LIC"). O'Brien subsequently financed a loan with Union Central on the property which provided a prepayment penalty of \$200,000.00. In a prior decision, this court held that because the LIC was in force for more than five years before the bankruptcy case was filed, James F. O'Brien, trustee, was a secured creditor of the debtor. In this decision we will hereafter refer to James F. O'Brien, trustee, as "O'Brien". We note that the creditor intends that Roger S. Corbley, Glen A. Burns and Carol Burns be included within the designation "James F. O'Brien trustee".

Debtor has presented a plan of reorganization in the case, which came on for hearing on confirmation. Class 3 in the plan was for "O'Brien Secured Claim". The plan proposes the treatment for O'Brien at paragraph 4.3.2 as follows:

4.3.2 Payment as Secured Claim: Subject to the filing of a proof of claim, O'Brien will be paid the purchase price for the property as specifically set forth in the LIC (after giving credit to Debtor for all amounts paid by Debtor to O'Brien or Union Central prior to or during this case, including but not limited to the Union Central Payoff Amount (as hereinafter defined), plus all interest provided for in the LIC accrued as of the Effective Date, plus late charges specifically provided for under Section 9 of the LIC, but NOT including any other amounts, including but not limited to prepayment penalties

and/or unearned or future interest accruing after the Effective Date (the "Purchase Price"). The Purchase Price shall be paid in full, in cash, contemporaneously with closing on the Effective Date, and shall constitute payment in full of all obligations and amounts due under the LIC. Simultaneously with the payment of the Purchase Price and the Union Central Payoff Amount, O'Brien shall transfer title to the Property to the Debtor free and clear of all liens, claims, and encumbrances.

Unless O'Brien files a proof of claim within the time prescribed by the Plan, the Purchase Price will be the amount of the claim scheduled by the Debtor, after deducting any payments made to O'Brien or Union Central Life Insurance Company after the Petition Date. In connection with the payment of this claim, Union Central shall provide to Debtor a payoff statement as of the date of the closing including any and all amounts owed under its Note and related mortgage, including but not limited to prepayment penalties and late fees (the "Union Central Payoff Amount"). At closing, Debtor shall disburse the Union Central Payoff Amount directly to Union Central, and Debtor shall be entitled to a credit against the Purchase price in an amount equal to the Union Central Payoff Amount. Upon payment of the Union Central Payoff Amount, Union Central shall release its mortgage, liens, claims and/or encumbrances against the Property and the Assignment of Rents executed by Debtor.

Payment of the Union Central Payoff Amount shall not be deemed to act as a consent on the part of O'Brien to the accuracy of the payoff statement or the amount set forth therein. Payment of the O'Brien Claim shall not be deemed a waiver of any claims that Debtor may have against O'Brien arising out of O'Brien's conduct, all of which are specifically reserved for adjudication on a post-confirmation basis.

While recognizing that debtor was entitled, because of 11 U.S.C. §1123(b)(5), to modify the rights of O'Brien by providing for a payoff at confirmation rather than payments over time as

provided in the LIC, at the hearing, the court denied confirmation. This court held that O'Brien was entitled to damages by reason of breach of the provision that the contract could not be prepaid. The court then set a hearing on the amount of damages to which O'Brien was entitled.

At the hearing each party presented the testimony of two experts.

A. O'Brien's Witnesses

1. Jamal A. Rashed, Ph.D.

O'Brien's first witness was Jamal A. Rashed, Ph.D, an economics professor at Xavier University. Dr. Rashed's analysis of O'Brien's damages was based upon the future stream of cash flow that by its terms the LIC was to provide for O'Brien. Dr. Rashed took the future LIC payments and discounted those payments to present value. In doing this he stated in his report that he employed an interest rate of 4.25% "derived from the June 1, 2005 average yield on the benchmark 10 year and 30 year treasury bonds." Based upon this analysis, Dr. Rashed testified that a payment of \$4,512,914 to O'Brien by the Debtor would ensure that O'Brien would receive future cash flows from an investment in treasury bills that would equal the payments outlined in the LIC.

2. Michael Veneman, CPA

O'Brien's second witness was Michael Veneman, a Certified Public Accountant. In his analysis, Veneman took the net amount O'Brien would receive under the LIC after taxes if payments were made for the life of the contract by its terms. He then used an interest rate of 4.25% to calculate that the total payments under the contract held a future value in the year 2020 of \$2,727,934. The interest rate was "derived from the June 1, 2005 average yield on the benchmark 10 year and 30 year treasury bonds." Veneman then calculated the proceeds that O'Brien would receive if the LIC was paid in full as of July 1, 2005. By utilizing the same treasury bond interest rate he calculated that the future value of those proceeds in 2020 would equal \$885,300. Thus, Veneman concluded that the total damages to O'Brien as a result of an early payoff of the contract was \$1,215,930 which equals the difference between the net future value of the LIC payments and the future value of an immediate payoff.

B. Debtor's Witnesses

The Debtor also relied on two experts to assess the amount of damages suffered by O'Brien as a result of an early payoff of the LIC. The first was an expert in real estate investments, and the second was an expert in financial investments.

1. Barton Weprin

Weprin is a real estate broker affiliated with Sperry Van Ness Co. and deals exclusively in commercial real estate investment property. For the purposes of evaluation, Weprin assumed O'Brien would receive \$1,757,993, an amount O'Brien could then invest. The Debtor believes this is the amount that O'Brien would receive as a result of a payoff of the LIC on confirmation of debtor's plan. In his report, Weprin looked at possible investments in comparable properties. Weprin's analysis of the financial returns of comparable properties in Hyde Park are based upon a series of estimates that are provided by a subscription computer service. Weprin testified that O'Brien could take the payment received on confirmation and invest it in property comparable to Ravenswood. If it did this it would receive a return equivalent to, if not greater than the current 9% called for in the LIC.

2. Angelo A. DiMarzio, CFA, CPA, CFP

The Debtor's second witness, DiMarzio is an expert in the financial field. DiMarzio's testimony was based entirely upon possible investments that O'Brien could make in financial markets over a 15 year time span. That is, DiMarzio's starting point was the assumption that O'Brien would receive a lump sum payoff on confirmation of the plan, as provided in the plan. O'Brien could then invest that amount. DiMarzio calculated that

amount, utilizing the numbers provided in Veneman's Schedule 3, then adjusting them as shown in DiMarzio's Table 3, to arrive at an investable figure of \$1,757,993 which would be available to O'Brien on distribution following confirmation of Debtor's plan. In his analysis, DiMarzio believed that based upon the age and risk tolerance of O'Brien, placing 45% of the amount distributed in equity investments and 55% in bonds and treasury bills would be appropriate. He testified that the risk level involved in the financial investments were similar to the risk O'Brien took in entering into the LIC with the Debtor. Based upon this asset allocation, DiMarzio looked at two different models in attempting to determine the likely rate of return of O'Brien. After determining the likely rate of return to O'Brien from the financial investments, DiMarzio then compared the difference in the returns expected between the LIC and the investments.

The first model DiMarzio utilized to determine the likely rate of return from an investment in the financial markets is referred to as the historic audit method. He used this method to analyze historical returns of investment portfolios over rolling 15 year periods between 1926 and 2004. He found the average return over the time period equaled 8.44%, while the high return for a 15 year period was 13.38% and the low return was 3.68%. In the second model, known as a simulation approach

DiMarzio used a computer program to generate random, but statistically possible returns. The results are accurate to a 99% probability plus or minus three standard deviations. Using this approach, the average return was 8.23%. The highest return under the simulation approach was 16.01% and the lowest was .52%.

DiMarzio then took the numbers from both the historical audit method and the simulation approach and calculated the average return which equaled 8.34%. He then subtracted a management fee of .25% and ended with an average net return of 8.09%. DiMarzio then compared the difference between the interest that O'Brien would receive between the 9% LIC rate and the 8.09% average net return estimate. He was of the opinion that this difference was the measure of the damage to O'Brien. He found the present value of this difference to be \$195,992.00 and this in DiMarzio's opinion is the damage to O'Brien.

DISCUSSION

As indicated on p. 3 above our task in this decision is to determine the damages to which O'Brien is entitled. It is fundamental that in determining that amount we must apply state law. Unsecured Creditors Committee v. Strobach Real Estate Inc. (In re Highland Super Stores Inc.) 154 F. 3d 573, 578 (6th Cir. 1998) That court supported its conclusion of the applicability

of state law by reference to Vanston Bond Holders Protective Comm. v. Green 329 U.S. 156, 67 S.Ct.237, 91 L.Ed. 162(1946) and Butner v. United States 440 U.S. 48, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979).

The law applicable in the State of Ohio regarding damages for breach of contract is stated at 30 O Jur 3d, Damages Section 18:

Generally, a party injured by a breach of contract is entitled to their expectation interest, which is the injured party's interest in having the benefit of the bargain by being put in as good a position as that party would have been in had the contract been performed. The purpose behind granting a party contractual "expectation interest" damages is to give the aggrieved party benefit of its bargain and to put it in as good a position as performance would have done. Indeed, the sole purpose of contract damages is to compensate a nonbreaching party for the losses suffered as a result of a breach. Generally speaking, a party whose contract has been breached is not entitled to more than a party would have been entitled to had the contract not been breached. The damages awarded must be the natural and probable consequence of the breach or those damages that were within the contemplation of the parties at the time of making the contract. A party's recovery is limited to the loss actually suffered, and a party is not entitled to be placed in a better position than if the contract had not been breached.

The starting point in a consideration of damages in this case is the treatment of O'Brien in debtor's plan. That treatment consists of a lump sum payment to O'Brien upon confirmation of debtor's plan. That is, debtor has modified the rights of O'Brien under the LIC by presently giving him a lump

sum instead of annual payments thru the life of the LIC. The experts for both parties, and hence, the parties themselves, have agreed that the way to give O'Brien its "expectation interest" is to compute a total amount which would give O'Brien the means to receive what it would have received under the LIC. The difference between that amount and the plan payment would be O'Brien's damages. That is, the parties agree that by this means the requirements of state law for damages is met. They disagree, however, in how that total amount should be computed. This Court holds that DiMarzio's computation and method is correct.

In addition, the basis for the rate of return ought to incorporate the same degree of risk which O'Brien bore in entering into the LIC. While the LIC gave O'Brien an expectation interest in an annual income, that expectation interest was subject to all the risks inherent in any commercial transaction. Here the damages must be computed to put O'Brien in as good a position as he would have been in had the LIC been performed. A proper measure of damages, then, would be the short fall that would have accrued to O'Brien if that lump sum paid to him pursuant to the plan were invested, and the expected return accumulated.

Debtor's witness, DiMarzio, testified that the risk level

involved in the financial investments he considered were similar to the risk experienced by O'Brien in entering into the LIC. With that in mind, DiMarzio testified as to an appropriate investment plan for the distributed lump sum based upon the age and risk tolerance of the individuals comprehended by the term O'Brien. His opinion was that the risk tolerance in his program was similar to that which O'Brien accepted entering into the LIC. DiMarzio then developed an expected rate of return based upon his assumptions. In conclusion, he arrived at a measure of damages in the amount of \$195,992.00, representing the difference between what O'Brien would receive following the program of DiMarzio as against what O'Brien would have obtained had the LIC been fully performed.

This Court holds that the bases employed by DiMarzio in reaching his conclusion are valid and that his opinion as to the damages to which O'Brien is entitled is sound.

In reaching this conclusion, we hold that the opinions of both of O'Brien's witnesses, Rashed, and Veneman, must be rejected. Both utilized in their computations an interest rate derived from U.S. Treasury Bonds. Such a rate is consistent only with a totally risk free investment. O'Brien when he entered into the LIC did not have a risk free investment. And it is a matter of state law that O'Brien "is not entitled to be

placed in a better position than if the contract had not been breached." This is what the computation employed by Rashed and Veneman would have given O'Brien, and this would not be allowed under state law.

In addition Veneman charged the debtor \$200,000.00, a prepayment penalty required to be paid to O'Brien's mortgager Union Central when O'Brien refinanced its loan with Union Central. The debtor's only liability, however, is for "damages resulting from the breach that were within the contemplation of both parties at the time of the making of the contract." The Toledo Group, Inc. V Benton Industries Inc. 87 Ohio App. 3d 798,806 (Ct. App. Ohio 6th District, Lucas County). It is undisputed that the \$200,000.00 penalty arose from an agreement between O'Brien and Union Central entered into well after the date of the LIC. The prepayment due Union Central does not give rise to a liability for debtor.

Debtor may present a further amended plan consistent with this decision.

Copy to:

J. Michael Debbeler, Esq.
Graydon Head & Ritchey, LLP

1900 Fifth Third Center
511 Walnut Street
Cincinnati, OH 45202

John J. Schmidt, Esq
Dinsmore & Shohl
1900 Chemed Center
255 E. Fifth Street
Cincinnati, OH 45202

Louis Solimine, Esq
Thompson Hine LLP
312 Walnut Street
Cincinnati, OH 45202

Office of the U.S. Trustee
36 E. Seventh Street
Cincinnati, OH 45202

#